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The History of the Investment Tax Credit

Rachael I. Lambert

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THE HISTORY OF THE INVESTMENT TAX CREDIT

Rachael Ingrid Lambert

Introduction

A tax credit is an incentive for businesses and individuals, which allows them to reduce their tax obligation. Federal and state governments grant tax credits in areas such as employment and the environment. An investment tax credit (ITC) allows businesses and individuals to reduce their tax obligation when they venture into new businesses and developments. It's meant for businesses and individuals to invest for continued growth. If the economy is in a slump, however, investments may drop by businesses and individuals. In hard economic times, the federal and state governments provide the ITC incentive to stimulate economic growth. The United States federal government has historically enacted ITCs in order to stimulate economic growth.

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Thesis Advisor Carol C. Bishop Date 8-21-13
Dr. Carol Bishop

Committee Member Fonda L. Carter Date 8.21.13
Dr. Fonda Carter

Honors Program Director Cindy Ticknor Date 8-21-13
Dr. Cindy Ticknor

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Introduction

A tax credit is an incentive for businesses and individuals, which allows them to reduce their tax obligation. Federal and state governments grant tax credits in areas such as employment and the environment. An investment tax credit (ITC) allows businesses and individuals to reduce their tax obligation when they venture into new businesses and developments. It is natural for businesses and individuals to invest for continued growth. If the economy is in a decline, however, investments may drop by businesses and individuals. In hard economic times, the federal and state governments provide the ITC incentive to stimulate economic growth. The United States federal government has historically enacted ITCs in order to stimulate business investment.

Private investment is vital to the business community. Existing businesses and individuals make new investments for a variety of reasons. Expansion can give a business an advantage by developing partnerships with other businesses or individuals from different industries. National, or even international, recognition from investing with partners will open new markets for a business. Investments help businesses and individuals achieve a greater rate of return and the benefits of the investment will more than likely outweigh its cost (Drury 233). The primary reason businesses and individuals invest is to earn higher profits in the future. In recent years there has been an increase in the number of individuals starting new businesses. In 2010, there were 565,000 businesses created each month by 0.34% of individuals (Clifford). Despite a weak economy, there were new ventures and investments which may have been impacted by the United States fiscal policies, such as tax credits or incentives.

ITC decreases the cost of capital and increases the stock of capital overtime at a stated percentage, which results in businesses purchasing new investments (Meyer 190). The investment impact is not as apparent under the permanent ITC because the results of capital expenditures spending appear over a long period of time (Larson 69). A distribution issue can occur with a permanent ITC in which investments can be altered (Larson 64).

Businesses that become aware of future legislation changes involving the investment tax credit will time their investments accordingly. In a business example, capital expenditures are purchased at \$100,000. The federal government passes new legislation that introduces a 5% permanent investment tax credit. The business will be able to deduct \$5,000 (5% of 100,000) from their taxes. The business will not see an immediate effect on its investment because the ITC is permanent. Results from the investment are revealed over the life of the capital expenditures purchased. If the capital expenditures have a useful life of ten years there will be a slow but steady decrease in investment spending. A few years later the business becomes aware that the permanent ITC will go up from 5% to 7% through new legislation. In order to take advantage of the new legislation the business will not invest in capital expenditures until the new permanent ITC is placed into law. After the 7% permanent ITC takes into effect the business will see positive results in its investment over the life of the capital expenditures.

President Kennedy Introduces the ITC

The investment tax credit was introduced in an effort to encourage private corporate investment in the midst of the 1960-1961 recession. The economic recession of 1960 and 1961 resulted in high levels of unemployment and low levels of housing and steel

production. United States businesses had not increased their investments in plant and equipment (Porter, "1960" 19). As a result, capital projects in the United States were not up-to-date and the country experienced difficulty in market competition ("Kennedy" 2).

President Kennedy believed that an ITC would provide an extra boost to the economy. would be used, what capital projects would be eligible for the incentive, why the ITC is

used for In his presidential address to Congress on April 20, 1961, President Kennedy urged Congress to include an investment credit plan in the economic package. He stated, "the investment incentive itself can contribute materially to achieving the prosperous economy under which this incentive will make its maximum contribution to economic growth.

Rather than delaying its adoption until all excess capacity has disappeared and unemployment is low, we should take this step now to strengthen our anti-recession program, stimulate employment and increase our export markets" (Woolley). The investment tax credit envisioned by President Kennedy was intended to decrease the levels of unemployment through the creation of industrial jobs and increase the levels of housing and steel production that were affected by the recession.

President Kennedy's suggestion of an investment tax credit was innovative for the United States. A few international countries offered an ITC in the 1950s for local businesses (Moonitz 47). The difference between the ITC used in other countries and the investment tax credit proposed in the U.S. was in its timing. A few foreign countries allowed businesses to claim an ITC in advance of withholding taxes from income, whereas the U.S. proposal allowed businesses to use the ITC after withholding taxes (Moonitz 47). While the foreign and U.S. ITC have the same purpose, businesses are granted a direct incentive on taxes in the U.S, as opposed to foreign countries. The incentive for investment economy, not the U.S. economy. Under President Kennedy's plan, businesses could use the

helped the U.S. compete with other countries for markets and “compete with foreign goods in price and quality, both at home and abroad” (Woolley).

President Kennedy’s Congressional address specified how the investment tax credit would be used, what capital projects would be eligible for the incentive, why the ITC is used for investment, and what effect it would have on revenue loss compared to accelerated depreciation. President Kennedy’s proposed 15% ITC for purchases of capital assets with at least a six-year useful life was intended to provide a greater tax benefit than the depreciation allowances offered at the time (Woolley). A depreciation allowance is the portion of the capital expenditure cost deducted as depreciation from annual taxes. The ITC was offered to encourage businesses to acquire capital expenditures or advance current expenditures that help them compete globally. If capital expenditures were not greater than the depreciation allowances, President Kennedy proposed a 6% ITC on new capital expenditures that were 50%-100% of depreciation allowances (Woolley). In addition to the 6% ITC, businesses would also be granted a 10% ITC on new capital expenditures that would apply on the beginning \$5,000 paid (Woolley). The ITC would only apply to capital expenditures that were private and new (Woolley). Under the ITC President Kennedy deemed buildings as ‘new plant’ and they were included as new investment (“Federal” 838). Businesses investing in public capital expenditures such as existing infrastructure were excluded from using the ITC because the federal government provides incentives to them through other subsidies. The ITC was limited to private capital expenditures in the United States for expansion and modernization. If the incentives were granted for capital expenditures in a foreign country it would benefit that country’s economy, not the U.S. economy. Under President Kennedy’s plan, businesses could use the

ITC to reduce no more than 30% of its taxes. If the ITC was not fully used to reduce taxes, businesses could carry it over to up to five future years (Woolley). The proposed plan would result in a predicted \$1.7 billion loss to the U.S. Treasury but the immediate recovery of the U.S. economy was President Kennedy's primary concern (Woolley).

To illustrate the effect of President Kennedy's proposed investment tax credit in an example unrelated to the previous one (Table 1), assume that a business invests \$100,000 of capital expenditures in the current year and has a pre-ITC tax liability of \$60,000. If the current capital projects investment exceeds 100% of the current depreciation allowance, a 15% ITC, or \$15,000, can be deducted from taxes through the ITC. If the current capital projects investment only exceeds 50% of the current depreciation allowance, the business can deduct a 6% ITC (\$6,000) from taxes. In addition, the business automatically deducts \$500 (10% of the first \$5,000 from the current capital projects investment).

Table 1		
ITC under Kennedy's Proposal		
	Kennedy – Investment > 100% depreciation	Kennedy – Investment > 50% depreciation
ITC Percentage	15%	6%
ITC - \$100,000 capital expenditure	\$15,000	\$6,500

Investment Tax Credit vs. Accelerated Depreciation

Investors that used the investment tax credit purchased capital expenditures that would be replaced after a few years because the ITC was appropriate for short-term

capital expenditures (Davies 140). Investors that used accelerated depreciation purchased capital expenditures that were irreplaceable or replaced after multiple years because accelerated depreciation was appropriate for long-term capital expenditures (Davies 140). If a business made a bad investment, the chances for it to experience a large loss of revenue were little under the ITC than accelerated depreciation (Blinder 73). Table 2 shows the amount of depreciation on \$100,000 in capital expenditures using three common depreciation methods.

Table 2			
ITC vs. Accelerated Deprecation			
Year (10 Year Useful Life)	Straight-Line (less 7% ITC)	Double Declining Balance	Sum of the Years Digits
1	\$9,300	\$20,000	\$18,182
2	\$9,300	\$16,000	\$16,364
3	\$9,300	\$12,800	\$14,545
4	\$9,300	\$10,240	\$12,727
5	\$9,300	\$8,192	\$10,909
6	\$9,300	\$6,554	\$9,091
7	\$9,300	\$6,554	\$7,273
8	\$9,300	\$6,554	\$5,455
9	\$9,300	\$6,554	\$3,636
10	\$9,300	\$6,552	\$1,818
Total Depreciation	\$93,000	\$100,000	\$100,000

(Staub) Under straight-line depreciation, businesses paid a fixed amount of depreciation over the life of the capital expenditure. When the investment tax credit is deducted from the annual depreciable amount, as calculated in Table 2, businesses see a reduction in taxes (Blinder 73). The advantage of using accelerated depreciation, like the two methods shown in Table 2, is that businesses do not have to pay taxes on the capital expenditures until the end of their useful lives. However, accelerated depreciation can only be presented once compared to the ITC (Blinder 72). Businesses can utilize the ITC each year they purchase new capital expenditures.

Opposition to ITC

Members of Congress and the business community opposed President Kennedy's proposal for the investment tax credit. Many in the business community preferred accelerated depreciation to the ITC because accelerated depreciation deferred tax liability and therefore reduced current tax liability. The accelerated depreciation method allowed businesses to use money saved from depreciation allowances to acquire or replace capital projects ("500,000" 1). Opponents to Kennedy's plan felt that accelerated depreciation gave businesses the opportunity to receive greater tax advantages on capital projects than if they used the ITC (Boskin 108). Congressman Byrnes from the House of Representatives believed that President Kennedy's proposal was a political move, and called the plan a "mere [gimmick]" that uses "untrustworthy procedures [to seek] governmentally decreed objectives" ("Byrnes" 43). Others criticized the ITC as an insufficient attempt at tax reform. Businessmen believed that the guidelines for depreciation were old and needed to be modified to increase investments. Some felt the ITC could not be deemed a reform

(Stanback 92). Members of the business community also had different opinions on how to value new capital expenditures when given the incentive of the ITC. Some believed capital expenditures should be valued at original cost while others preferred valuing them at original cost less the ITC (Moonitz 54).

As President Kennedy pointed out in his address, he recommended that businesses use the investment tax credit instead of accelerated depreciation. Businesses are provided an incentive to invest more under both the ITC and accelerated depreciation. As businesses paid for depreciation in the capital expenditure's first year, they risked paying higher taxes in later years under accelerated depreciation. There would be little, if any, money to save for future capital projects investment. Treasury Secretary Dillon agreed with President Kennedy's assessment that the ITC would be more useful than accelerated depreciation. The ITC, Secretary Dillon believed, was an incentive full of effectiveness that would "offset only income of companies that invested in qualifying property and would provide a greater net return on new investment" (Karzon 850-851). The House Ways and Means Committee felt a lot of pressure from the business community to make changes to President Kennedy's proposal. Wilbur Mills, chairman of the House Ways and Means Committee, agreed that any capital expenditures with a useful life between four and eight years were allowed only an ITC was needed but "feared that [the investment tax] credit would distort market-oriented economic decisions and lose excessive amounts of revenue" (Brownlee 321).

The Revenue Act of 1962

The Ways and Means Committee made several changes to President Kennedy's proposal. The committee approved an 8% investment tax credit rather than President Kennedy's 15% ITC for new capital expenditures - a 7% decrease (Moonitz 48). Businesses

were required to subtract the ITC from the capital expenditure's cost prior to determining depreciation (Jorgenson 103). Chairman Mills believed a lower ITC was easier to calculate due to a direct reduction in taxes, and that it was targeted to a wider range of businesses in comparison to the 15% credit, (Brownlee 321). The committee also removed President Kennedy's proposed 30% ITC limit on taxes in order to avoid punishing businesses with taxes under \$100,000 (Moonitz 48). The Ways and Means Committee approved an ITC that is up to half percentage of the taxes owed by businesses (greater than \$100,000 in taxes) in their proposal (Moonitz 48). President Kennedy allowed buildings to be included as new investments, but the Ways and Means Committee decided to eliminate that option (Moonitz 49). The business community's opposition to the ITC and the potential decline in revenue from the ITC contributed to the exclusion of buildings ("Federal" 839). The Ways and Means Committee made some additions to their proposal. Along with new capital expenditures, businesses were allowed to apply the ITC to used property worth no more than \$50,000 (Moonitz 49). In the business example from Table 1, the capital expenditures purchased were new and not old; therefore this provision would not apply. The Ways and Means Committee lowered a capital expenditure's useful life from six years to four years; any capital expenditures with a useful life between four and eight years were allowed only a portion of the ITC (Moonitz 49). In the business example from Table 1 the capital expenditures purchased would not qualify for the ITC given the ten-year useful life. The

ITC could partially be used by public utilities, which were not included in President Kennedy's proposal (Moonitz 49). The House Ways and Means Committee revised President Kennedy's proposal in order to satisfy the business community.

Kennedy - Investment > 100% depreciation	Investment > 50% depreciation	Revenue Act of 1962

The Ways and Means Committee sent the revised bill to the House of Representatives. The House of Representatives approved the proposal with few changes. Members of the House of Representatives voted on a 7% investment tax credit, down 1% from the Ways and Means Committee's proposed ITC and 8% from President Kennedy's proposed 15% credit (Moonitz 49). The House set the partial ITC for public utilities at 3% (Moonitz 49). The House approved an ITC that is up to 25 percent of the taxes owed by businesses (greater than \$25,000 in taxes); this lowered the percentage and tax amount proposed by the Ways and Means Committee by 25 percent and \$75,000, respectively (Moonitz 49).

The House of Representatives sent their approved proposal to the Senate. Senate approved the proposal with a few changes. The investment tax credit had to equal the depreciation basis used by a business (Moonitz 49). In addition to the five-year carry forward of the unused ITC, businesses can carry the ITC back three years for capital expenditures previously purchased (Moonitz 49). After the Senate approved the changes to the ITC, President Kennedy signed the Revenue Act of 1962 into law on October 16, 1962. Table 3 shows how the ITC changed from President Kennedy's proposal to the signing of the Revenue Act of 1962, using the previous business example and assuming \$60,000 in pre-ITC taxes.

Table 3			
ITC Change			
	Kennedy – Investment > 100% depreciation	Kennedy – Investment > 50% depreciation	Revenue Act of 1962

ITC Percentage	15%	6%	7%
ITC - \$100,000 capital expenditure	\$15,000	\$6,500	\$7,000
Total Taxes in First Year	\$45,000	\$53,500	\$53,000

The amount of allowable investment tax credit decreased from President Kennedy's proposal to its official enactment. As Table 3 shows, a business still pays less in taxes with the use of the 7% ITC enacted through the Revenue Act of 1962 as compared to the \$60,000 pre-ITC tax liability.

When the Revenue Act of 1962 was passed, President Kennedy intended for the investment tax credit to be permanent (Lintner 113). However, the Revenue Act of 1962 actually implemented the ITC as a temporary investment tax credit. The enactment of the 7% permanent investment tax credit (that was actually temporary) increased investment spending and capital instantaneously; however, total consumption decreased as a result of the ITC (Ljungqvist 341). The decrease in consumption most likely is a result of businesses placing resources in capital expenditures like equipment (Davies 140). Thus, the ITC made an immediate and progressive impact in the early 1960s.

Conflicts in Accounting Treatment

With the enactment of the Revenue Act of 1962, the accounting profession had to determine the proper accounting treatment for the investment tax credit. In 1963 the Accounting Principles Board (APB) released *APB Opinion No. 2* to help businesses address the issue. Under this pronouncement the APB specified that the ITC should be "treated ... as a reduction in the cost of the asset and therefore ... reflected over the life of the asset

through reduced depreciation charges” (Schroeder 8). This accounting treatment, known as the deferred method, was the standard that the APB felt should be used for financial reporting. The Securities and Exchange Commission (SEC) countered the APB’s Opinion by stating that the ITC should be “treated . . . as a decrease in income tax expense in the year it occurred” (Schroeder 8). Businesses, according to the SEC, should have the option of using the flow-through method for their financial statements.

Under the flow-through method, current year taxes are reduced by the amount of the investment tax credit. Table 4 below shows the flow-through method using the previous example in Table 3 through the Revenue Act of 1962, assuming \$60,000 in taxes:

Table 4	
Flow-Through Method	
Taxes before ITC	\$60,000
Less: Investment Tax Credit	\$7,000
Taxes in Current Year	\$53,000

As Table 4 shows, the 7% investment tax credit taken on the \$100,000 capital expenditure decreases the taxes owed by a business. When the ITC is taken in the first year by a business, net income increases – a positive result for investors (Moonitz 53). Under the deferred method the ITC reduces taxes over the useful life of the capital expenditure. Table 5 shows how the business from the example would report taxes and the ITC throughout the life of the capital expenditure:

Table 5	
Deferred Method – Future Years	
Taxes	\$60,000
Less: Investment Tax Credit	\$700
Taxes in Future Years	\$59,300

The taxes owed by the business are reduced by an amount equal to the investment tax credit over the capital expenditure's useful life. Under the business example from Table 5 the \$7,000 ITC from the capital expenditure's cost is spread out over the ten-year useful life (\$700 in each year). Table 6 demonstrates that the business will pay the same amount in total taxes throughout the capital expenditure's useful life:

Year 1	\$60,000	\$59,300
Year 2	\$60,000	\$59,300
Year 3	\$60,000	\$59,300
Year 4	\$60,000	\$59,300
Year 5	\$60,000	\$59,300
Year 6	\$60,000	\$59,300
Year 7	\$60,000	\$59,300
Year 8	\$60,000	\$59,300
Year 9	\$60,000	\$59,300
Year 10	\$60,000	\$59,300
Total	\$593,000	\$593,000

As Table 6 shows, a business will pay a lesser amount in taxes under the flow-through method in the first year of the capital expenditure because the investment tax credit was fully used. In future years, however, the business will pay less under the deferred method each year because the ITC was amortized over the capital expenditure's useful life.

The Accounting Principles Board had determined proper accounting treatment after the investment tax credit was enacted in the Revenue Act of 1962 because there was no guidance in the accounting standards. The APB decided that the business should use the

Table 6		
Business Taxes		
Useful Life	Flow-Through Method	Deferred Method
Year 1	\$53,000	\$59,300
Year 2	\$60,000	\$59,300
Year 3	\$60,000	\$59,300
Year 4	\$60,000	\$59,300
Year 5	\$60,000	\$59,300
Year 6	\$60,000	\$59,300
Year 7	\$60,000	\$59,300
Year 8	\$60,000	\$59,300
Year 9	\$60,000	\$59,300
Year 10	\$60,000	\$59,300
Total	\$593,000	\$593,000

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no precedent or theory to follow (Moonitz 52). Instead of depending on accounting theories the APB had to trust the language embedded in the Revenue Act of 1962 in passing *APB Opinion No. 2* (Moonitz 53). The APB focused on how the ITC would influence net income; hence their opinion used the deferred method (Moonitz 54). They were strong-minded about the deferred method because the income for a business should reflect its true position without any misrepresentations (the ITC would misrepresent income) (Moonitz 55).

The Securities Exchange Commission (SEC) opposed the APB's opinion that businesses should use only one accounting method on their financial statements for the investment tax credit. The requirement that businesses use one accounting method would result in many objections from the business community, particularly from businesses registered under the SEC (Moonitz 58). The SEC also believed that businesses should also have the opportunity to value new capital expenditures any way they pleased (Moonitz 54). While the SEC appreciated the APB's efforts to create pronouncements acknowledged by all, they wanted to avoid potential legal issues arising from *APB Opinion No. 2* (Moonitz 59). The SEC made their position official with the passing of *Accounting Series Release (ASR) No. 96*.

The Accounting Principles Board used the investment tax credit as an opportunity to generate a pronouncement for the accounting field through *Opinion No. 2* (Moonitz 48). President Kennedy's administration believed the deferred method through *Opinion No. 2* would not achieve the purpose of the ITC enacted in the Revenue Act of 1962 (Schroeder 8). After the release of *ASR No. 96* and the backlash from the business community the Accounting Principles Board decided to pass *APB Opinion No. 4*. Under this new pronouncement, the APB voided *Opinion No. 2* and allowed businesses the option to use the

flow-through method. They emphasized, however, that the deferred method was the “proper and most appropriate” method in reporting the ITC (Schroeder 8). With the passing of *APB Opinion No. 4*, the chance to create new precedence was overall ineffective (Moonitz 47).

The Revenue Act of 1962's Impact on Investment

When the investment tax credit was officially enacted in the Revenue Act of 1962, there was a mixed reaction from politicians and the business community. The U.S. Chamber of Commerce, the spokesman for small businesses, believed the ITC would be unfair toward small businesses (Brownlee 368). Members of the business community did not want the federal government to decide their investment choices (Brownlee 368). Some Democrats in Congress felt there was no validity to the claim that the ITC would impact the growth of business (Brownlee 215). However, some business institutions viewed the ITC as a positive incentive. Private banks, for example, accepted the ITC because the federal government was vitally involved in investment stimulation for the U.S. economy (Brownlee 366). Overall, the ITC caused controversy throughout the country.

There was an immediate economic impact after the official enactment of the investment tax credit. First, the ITC contributed to a decrease in business taxes to 3.6% of Gross National Product (GNP) in 1962, a 0.6% decrease from two years prior (Brownlee 325). The enactment of the Revenue Act of 1962 allowed businesses to retain \$90 billion, which would have been paid in taxes, for almost two decades after the creation of the ITC (Brownlee 325). Secondly, owners of businesses were more encouraged to invest in capital expenditures due to the ITC incentive (Hall 391). Businesses planned to invest in around

\$1.2 billion the year after the ITC's enactment (Rotstein 23). The purchases of capital expenditures by businesses went up 7.7% from 1962-1965 and 10.2% from 1962-1967 as a result of the ITC (Jorgenson 185). The ITC helped surge equipment investments by businesses by \$8.5 billion in 1963 (Hall 410). The ITC accounted for 10% of the 1963 equipment investment (Hall 410). Within the first year of the enactment of the ITC, investments went up beyond 40% for equipment (Davies 140). Next, the ITC also made an impact on goods purchased by producers. Between 1962 and 1966, purchases basically doubled each year as a result of the ITC (Jorgenson 187). Finally, the ITC was partially credited for significant innovations under President Kennedy's administration - including NASA and placing the first man on the Moon (Rotstein 24). President Kennedy's goal of putting the economy back on track appeared to be working through the ITC.

The Revenue Act of 1964

The investment tax credit was a vital incentive from the federal government to grow the U.S. economy and lower the unemployment rate. In 1963 the unemployment rate was 5.5% (Conway 5). To address the country's employment problem, the Revenue Act of 1964 was passed under President Johnson (Karzon 851). The Revenue Act of 1964 removed the requirement that the ITC had to be taken from a capital expenditure's cost for depreciation (Poterba 136-137). If the ITC is deducted from cost before calculating depreciation, as required through the Revenue Act of 1962, a business would have to pay more taxes in the latter part of a capital expenditure's useful life (Karzon 852). As a result of the removal of the requirement, called the Long Amendment, the ITC functioned as the federal government envisioned - an incentive that lowered the purchase price of capital expenditures (Karzon 852). The ITC continued to act as a temporary ITC.

The Revenue Act of 1964 resulted in continued growth to the U.S. economy. The GNP increased and the unemployment rate decreased after the enactment of the Revenue Act of 1964 (Conway 5). Businesses experienced a decrease in taxes, which helped them invest in more capital expenditures (Romer 774). The decline in unemployment was in large part due to businesses purchasing new capital expenditures, which resulted in an increase in investment spending for the economy (Conway 5). President Johnson signed the Revenue Act of 1964 to not only address the employment problem in the country, but also to develop economic growth for the future (Romer 770). He believed that high taxes were causing the investment tax credit to not fully function as enacted in the Revenue Act of 1962 (Romer 774). Accounting was difficult for businesses that used the ITC under the Long Amendment; the issue disappeared after the enactment of the Revenue Act of 1964 (Palash 30). With the ITC working as originated, the federal government continued the incentive due to the positive state of the economy.

The 1966 Suspension of the ITC

The investment tax credit put the United States economy back on the right track. Businesses were investing in capital expenditures, particularly equipment and machinery, at increased amounts (Karzon 852). In October of 1966, the demand from businesses surpassed the supply of capital expenditures (Karzon 852). The federal government, under President Lyndon B. Johnson, had to take control of the inflation by suspending the temporary investment tax credit (Karzon 852). The suspension affected capital expenditures invested by businesses from October 10, 1966 to March 9, 1967 (Karzon 852). At the time, business capital expenditure investments superseded the Gross National Product, which resulted in concern over the fast rate of investment demand (Peters,

“Lyndon”). Interest rates increased and the number of skilled factory workers decreased as a result of the high demand for capital expenditures (Peters, “Lyndon”). The suspension of the ITC would help bring interest rates down and increase job availability for factory workers. The ITC suspension would also relieve the capital expenditure industries from months of business orders for capital expenditures (Peters, “Lyndon”).

The 1966 investment tax credit suspension laid out guidelines for businesses to follow regarding the ITC. Businesses were not generally granted an ITC for capital expenditures purchased during the suspension period (Donaldson 388). If a business decided to utilize the capital expenditures, the disallowed ITC was subtracted from the investment tax credit that would have been granted during the period (Donaldson 388). Businesses with capital expenditures were exempted from the suspension if the useful lives of the investments were very long (Donaldson 388). If capital expenditures were acquired in a contract they were also exempt from the suspension (Donaldson 388). If an ITC was utilized on capital expenditures during the suspension period, the ITC would be deferred to 1968 (Porter, “Switching” 22).

Originally the suspension period was supposed to end on December 31, 1967 (Donaldson 388). However, when businesses reduced capital expenditures, the investment tax credit suspension ended on March 9, 1967, nine months before the original end date (Lintner 126). Expenditures decreased toward the last three years of the decade as a result of the ITC suspension (Lintner 126). Even after the temporary ITC was restored, the economy showed signs of a decline throughout 1967 (Lintner 126). Once the suspension of the ITC ended, businesses could receive an ITC that lowered taxes by \$25,000 and could add half of any leftovers that exceeded \$25,000 (Donaldson 389). Businesses could carry

unused ITCs an additional two years (from the five established in the Revenue Act of 1962) (Donaldson 389). The Revenue Act of 1966 also granted U.S. businesses the right to apply the ITC on their international capital expenditures (Donaldson 389).

The Tax Reform Act of 1969

The U.S. economy continued to grow in the latter part of the 1960s. The investment tax credit helped stimulate the economy just as President Kennedy envisioned it could. President Nixon feared that the ITC would cause inflation, which occurred in 1966 (Conway 6). He believed that due to the state of the economy, the ITC was not very important to spur economic growth for that period of time (Peters, "Nixon: Special"). He stated that if the ITC was not removed, revenues would decrease by \$1.6 billion (Peters, "Nixon: Letter"). President Nixon signed the Tax Reform Act of 1969, which terminated the temporary investment tax credit (Conway 6). Critics found it strange for President Nixon to terminate the ITC, because it gave many corporations a lot of wealth in spite of additional taxes (Pollack 77). In addition to inflation concerns, the federal government needed to remove the ITC in order to pay for the debt accumulated from the Vietnam War (Brownlee 426). The Nixon administration predicted only a minor drop in business capital expenditure purchases (Conway 6). They believed that the determination to invest by businesses, along with the progression of the U.S. economy, would remain positive (Conway 6).

After the Tax Reform Act of 1969, businesses decreased their investments in new capital expenditures between 1969 and 1970 (Jorgenson 189). During each of those two years, the purchases of capital expenditures by businesses decreased by 2.5% (Conway 6).

Investment tax rates increased in 1969 and 1970 by over 50%, which would explain the decline in investment (Landau 70). The termination of the investment tax credit was a major factor in the continued decline of the United States economy (Lintner 127).

The Revenue Act of 1971

When the United States economy needed another boost, President Nixon enacted the Revenue Act of 1971. The main areas the Nixon administration wanted to address in the new federal legislation included jobs, ventures outside of the United States, and the economy (Peters, "Nixon: Address"). The investment tax credit was restored when President Nixon realized its importance to the U.S. economy and the country's future (Conway 6). In the Revenue Act of 1971 the investment tax credit was titled the Job Development Investment Credit (Taubman 871). The Job Development Investment Credit continued to act as a temporary ITC.

Businesses could use the Job Development Investment Credit for specific capital expenditures: equipment, machinery, and cattle (Taubman 873). The capital expenditures had to have at least a three-year useful life and the seven percent credit applied to capital expenditures with at least a seven-year useful life. A useful life between three and seven years would give businesses a portion of the Job Development Investment Credit (Taubman 872-873). A four percent Job Development Investment Credit was also granted to public utilities (Palash 30). Restrictions also prevented individuals from taking advantage of the Job Development Investment Credit by entering into leases for non-business purposes (Corbett 81).

President Nixon wanted the Job Development Investment Credit to be ten percent in year one and five percent in year two and later years but Congress stuck with a seven percent credit (Brownlee 240). He also wanted the proposed 10% Job Development Investment Credit to be temporary but Congress did not include his proposal in the Revenue Act of 1971 (Taubman 885). Like the Revenue Act of 1962, the Job Development Investment Credit was intended to stimulate the economy and improve U.S. company's ability to compete with other countries (Peters, "Nixon: Address"). Both Acts applied the investment tax credit to new capital expenditures (Karzon 852). The Job Development Investment Credit gave public utilities one percent more than the investment tax credit in the Revenue Act of 1962 (Palash 30).

The Job Development Investment Credit was supposed to decrease the cost businesses paid for capital expenditures by ten percent (Taubman 882). The inclusion of the Job Development Investment Credit in the Revenue Act of 1971 was supposed to result in higher employment and a higher Gross National Product (Taubman 883). Capital expenditure purchases were supposed to spur investments immediately after the enactment of the Revenue Act of 1971; instead, investments increased in the following two years (Lintner 127). According to Paul Taubman, while a \$1 billion increase in business investments and a \$1.3 billion Gross National Product increase occurred two years after using the Job Development Investment Credit, there would be little, if any, increases to employment rates (883). Investment tax rates decreased over 50 percent the first two years after the Revenue Act of 1971 (Landau 70). Overall, the Revenue Act of 1971 helped improve the U.S. economy.

The Tax Reduction Act of 1975

During the 1960s, the investment tax credit drove a growing United States economy; the 1970s mostly suffered through a declining economy (Conway 6). The economic growth from the 1960s carried inflation over to the next decade, which was the primary cause for a new recession (Conway 6). Even though the Revenue Act of 1971 restored the ITC, it did not appear to be a factor in the economy's decline. Businesses decreased capital expenditure purchases because of the recession; this resulted in a seven percent drop in the years 1973, 1974, and 1975 (Conway 6). President Ford addressed the economic issue by signing the Tax Reduction Act of 1975 (Conway 6).

The Tax Reduction Act of 1975 raised the investment tax credit to ten percent, up from the seven percent enacted in the Revenue Acts of 1962 and 1971 (Karzon 853). The ITC was targeted to help businesses that experienced shortages in machinery (Peters, "Gerald"). Originally President Ford proposed a twelve percent ITC for the Tax Reduction Act of 1975 (Campagna 12). The ITC increase would help businesses save \$4 billion in taxes for that year (Campagna 12). Congress elected to raise the ITC to ten percent, which would help businesses save almost \$3 billion (Campagna 13). The ITC for public utilities was also increased to the new percentage (Palash 31). The Tax Reduction Act of 1975 allowed businesses to carry the ITC over four years (Karzon 853). Even though the ITC percentage increased, the ITC continued to act as a temporary ITC.

There were slight improvements in the U.S. economy after the enactment of the Tax Reduction Act of 1975. The Gross National Product increased and employment slightly improved in the year after the legislation's enactment (Campagna 12). The year 1976 brought a decrease in capital expenditure purchases by businesses (Campagna 15). Businesses paid lower taxes initially but the temporary investment tax credit increase

would not keep taxes low for the long-term (Romer 773). In 1975, investment tax rates decreased over 40 percent as a result of the ITC increase (Landau 70).

The Revenue Act of 1978

President Carter continued the thought process of President Kennedy that business investment will drive the United States economy in the long run. The ten percent temporary investment tax credit, originally introduced in the Tax Reduction Act of 1975, was made permanent through the Revenue Act of 1978 (Jorgenson 83). In contrast to previous Revenue Acts, businesses were able to apply the ITC to previously-owned capital expenditures (Briner 536). The 50 percent limit for ITC application was increased by ten percent between 1979 and 1982, with 90 percent being the maximum limit (Briner 537). Businesses could not apply the ITC to new buildings, but they could use the incentive on building renovations (Briner 537). The building renovations could not exceed \$100,000 if a business wanted a ten percent ITC (Briner 537). The Revenue Act of 1978 also granted businesses job, energy, and earned income credits (Briner 539-543).

Businesses benefitted from President Carter's investment tax credit. A permanent ITC was projected to save businesses \$2.5 billion in annual taxes (Peters, "Carter"). The increase in the ITC gave businesses more freedom to make future capital expenditure purchases (Peters, "Carter"). The increase in the tax ceiling gave smaller businesses a level playing field against their competition (Peters, "Carter"). Businesses suffered from an almost 20% increase in investment tax rates due to the increase in inflation rates in 1979 (Landau 70).

The Economic Recovery Tax Act of 1981

The United States economy declined during the beginning of the 1980s. Inflation was around eleven percent between 1978 and 1981 (Conway 7). Senator Lloyd Bentsen believed an investment tax credit was necessary for the United States “to put more goods on the shelves” (Shlaes). The investment tax credit continued through the Economic Recovery Tax Act of 1981 (Conway 7). President Reagan continued the ITC in the 1981 federal legislation to combat inflation (Conway 7). The ITC was granted for capital expenditures not included in previous legislation (Karzon 857). Businesses using the ITC for buildings had three options instead of the one introduced in the Revenue Act of 1978 (Karzon 858). The permanent ITC remained at ten percent, which was established in the Revenue Act of 1978 (Karzon 859). Businesses could use any remaining ITC up to 15 years, an additional eight years from the stated number in previous legislation (Karzon 863). Businesses were able to pass any unused ITCs to other businesses; financial benefits would be gained by both businesses in the transaction (Conway 7). A few capital expenditures were given a greater ITC (Conway 7). Businesses could only apply a portion of the ITC relative to a capital expenditure’s useful life (Davies 140).

Initially, businesses did not invest in capital expenditures after the continued investment tax credit was enacted. Some businesses avoided capital expenditure purchases all together (Shlaes). If businesses used all of the ITC for their investments, half of the investment tax credit would reduce the basis (Conway 9). The ITC resulted in an increase in economic growth, but it also resulted in an increase in interest rates and a major bill for the federal government (Shlaes). Throughout the 1980s, the U.S. economy’s debt increased by over 20 percent (Rotstein 24). The ITC added to the economy’s debt and did not operate as well as the ITC enacted in the Revenue Act of 1962 (Rotstein 24-25).

Section The Accelerated Cost Recovery Schedule (ACRS) was included in the Economic Recovery Tax Act of 1981. ACRS was included in the federal legislation to increase the production of equipment and machinery (Karzon 847). ACRS gave businesses the opportunity to deduct depreciation from their investments at a faster rate (Conway 7). ACRS ultimately was an accelerated version of accelerated depreciation. Under ACRS, businesses base capital expenditures on five different recovery classes instead of the useful life (Karzon 860). As a result, businesses would receive an investment tax credit for three-year useful life purchases under the three-year recovery class (Karzon 860). Capital expenditures under ACRS were written off more quickly than under normal depreciation (Conway 9). Businesses using ACRS would have \$5,000 removed from their capital expenditure purchases (Conway 9). The ITC provisions were changed to align with ACRS (Pollack 91).

The Tax Reform Act of 1986

When President Ronald Reagan signed the Tax Reform Act of 1986, the investment tax credit was eliminated from federal legislation (Carlson 33). Members of Congress stated that the ITC was not productive for the U.S. economy; it essentially was a grant (Carlson 33). The ITC allowed businesses to invest in capital expenditures with a negative net present value, which Congress wanted to avoid (Carlson 34). The Tax Reform Act of 1986 also introduced a modified version of ACRS (Conway 9). Prior to 1986, businesses were prepared to lower all investment costs by \$10,000 in 1989 through the 1981 ACRS (Conway 9). Under the modified ACRS, businesses could not exceed \$200,000 in annual investments if they wanted to deduct \$10,000 (Conway 10). The \$10,000 deduction is under

Section 179 (United 34). The new depreciation system essentially replaced the ITC to spur business investment (Brownlee 426).

The abolishment of the investment tax credit resulted in less investments by businesses (Carlson 34). In 1986, business investment decreased by \$225 million as a result of the Tax Reform Act of 1986 (Conway 35). Manufacturing firms decreased capital expenditure purchases by almost twelve percent due to no ITC (Carlson 37). Rental rates increased and capital stock decreased after the ITC elimination (Conway 35). Capital expenditures for farms had a ten percent growth in rental rates (Conway 37). If the ITC had not been repealed, business investment in capital expenditures would have increased by 14.1 percent (Jorgenson 190).

Recent Administrations' Attempts to put ITC in Federal Legislation

There were attempts by recent presidential administrations to introduce the investment tax credit for economic growth. These attempts will be highlighted in the following paragraphs. Currently, businesses have investment incentives through the American Recovery and Reinvestment Act and Section 179. These investment incentives will be detailed separately.

President Clinton proposed an ITC during his first year in office. Under President Clinton's proposal, the ITC would be granted for equipment capital expenditures in an incremental manner (Clark 330). Small businesses could have applied for a seven percent ITC in 1993 and a five percent ITC in 1994 (Clark 333). Large businesses could have 70 percent and 80 percent exclusions in the bases of their capital expenditures in 1993 and 1994, respectively (Clark 333).

There were mixed reactions to President Clinton's investment tax credit proposal. Economists believed that up to 500,000 jobs would be created and the deficit would improve slightly as a result of the ITC (Greenhouse). Businesses and industries involved in equipment production were likely to benefit most from the ITC (Greenhouse). The ITC under President Clinton was projected to increase investment spending by \$20 billion (Greenhouse). President Clinton's proposal for an ITC was not welcomed by businesses because it would force them to hold off on making capital expenditure investments (Pollack 122). Under the proposal, businesses would profit from the ITC when they postponed their investment acquisitions (Pollack 122). However critics predicted that the proposed ITC would not have an impact on the economy, and that it would add to the federal deficit (Pollack 122). People against the proposal believed the ITC would provide a disadvantage to businesses that invested during the early 1990s recession (Greenhouse). They also did not like the fact that the ITC only applied to certain investments (Greenhouse). President Clinton's proposal failed to pass in Congress, similar to President George H.W. Bush's proposed ITC in 1991 (Greenhouse).

President George W. Bush's administration introduced incentives for business investments during his two terms in office. The September 11, 2001 attacks on the United States resulted in a decline in the economy (Larson 64). To place the economy back on the right path, H.R. 3090 was ordained in the House of Representatives (Larson 64). The bill, called the Job Creation and Worker Assistance Act of 2002, introduced a temporary partial expensing provision that acted as an investment tax credit (Larson 64). Businesses that purchased new equipment could expense 30 percent of the capital expenditures through two years (Larson 65). The incentive would result in more purchases by businesses

and more optimism by American citizens (Peters, "Bush: Statement"). While costs would decreased for businesses, there was not a big impact on investments as a result of the provision (Diamond 205). In 2003, President Bush signed the Jobs and Growth Tax Relief Reconciliation Act (Diamond 191). Under this legislation, businesses could expense 50 percent of their investment purchases – a 20 percent increase from 2002's legislation (Diamond 205). Like the previous year, investments barely increased after the legislation's enactment (Diamond 206). In 2008, President Bush signed the Economic Stimulus Act to improve the economy (Peters, "Bush: Remarks"). Investment incentives were introduced for an increase in job creation (Peters, "Bush: Remarks").

The American Recovery and Reinvestment Act

President Barack Obama signed the American Recovery and Reinvestment Act of 2009 to put the economy back on the right path. The legislation includes tax credits and other incentives that will increase investment and decrease taxes for businesses (Lim). The investment tax credit was mainly in the form of a temporary expensing provision (Lim). President Obama's plan was projected to result in approximately 4 million new and spared jobs (Peters, "Barack"). The American Recovery and Reinvestment Act would bring long-term economic growth through immediate investment by businesses (Peters, "Barack").

The American Recovery and Reinvestment Act provide incentives for businesses and individuals – the incentives for businesses will solely be highlighted. Businesses are able to deduct investment purchases by no more than \$250,000 through expensing (Lim). The United States government would see a decline in revenue during the first years after the legislation's enactment but would recover the loss in the long term (Lim). Businesses

that invested in energy could apply for various investment incentives (Lim). Taxes would decrease for businesses while expenses would increase for the U.S. government (Lim). Businesses could apply for the Work Opportunity Tax Credit if they employ citizens with liabilities (Lim). If businesses invest in disadvantaged communities they could apply for the New Markets Tax Credit (Lim).

Section 179

In 1954, businesses were given two choices when calculating annual depreciation on new investments. The first, original choice was the straight-line method, which writes an investment off over its useful life (Keith 115). The business community did not favor the straight-line method due to the way it was distributed to businesses (Keith 110). They also had an issue with the Internal Revenue Service dictating the deduction term for capital expenditures (Keith 110). The second, new choice was the declining-balance method, which deducts almost 70 percent of an investment's cost in the beginning years of the investment (Keith 110). While businesses were able to depreciate more at an earlier time, they could apply the second choice solely on new investments (Keith 110). The declining-balance method drew criticism from the business community over the required investments and the future demand for new investments (Keith 110-111).

The Committee on Small Business under President Eisenhower heard the outcry from the business community and in 1956 proposed the declining-balance method be available for up to \$50,000 of used capital expenditures (Keith 114). President Eisenhower approved the Committee's proposal and asked the Ways and Means Committee to consider it (Peters, "Dwight"). The Senate Small Business Committee also approved the declining-

balance method (Keith 114-115). The Ways and Means Committee sent their proposal to the House of Representatives on July 16, 1958 (Keith 115). Under the proposal, small businesses are able to lower the costs of all capital expenditures by 20 percent (Keith 115). Businesses could not apply the deduction on investments over \$10,000 (Keith 115). The provision in the proposal passed in the House of Representatives and the Senate and was officially enacted as the Small Business Tax Revision Act of 1958 (Keith 115). The business example from Table 1 would not be eligible for the provision since the investment costs exceed \$10,000.

The business community wanted changes to federal legislation involving taxes. Businesses at the time deducted investments through accelerated depreciation (Martin 115). Small businesses advocated for an expensing incentive to be included in federal legislation (Martin 115). The business community did not enjoy the complexity accelerated depreciation brought to accounting (Martin 115). When the Reagan administration proposed ACRS, the small business community believed it favored large businesses (Martin 121). Small businesses preferred the expensing incentive because they could depreciate investments at a faster rate (Martin 121). Politicians were not willing to include the expensing provision because it would bring little revenue to the economy (Martin 145).

In the Economic Recovery Tax Act passed by President Reagan, the 20 percent deduction from the Small Business Tax Revision Act of 1958 was terminated (Black 180). Businesses were given an incentive through expensing (Black 180). The Section 179 expense had to be deducted from the investment's cost (Black 180). Businesses are required to use the expense on their tax filing's income and not on the capital expenditure (Black 180). The Section 179 expense must be used in the investment purchase year (Black 180). The

incentive could be used on investments costing up to \$5,000 in 1982 (Martin 108). If investments were not used for business the incentive must be reported (United 34).

The Section 179 expense endured some changes after its enactment. Section 179 was increased to \$10,000 under the Tax Reform Act of 1986 (United 34). If capital expenditures exceeded \$200,000, the excess amount would be deducted from the \$10,000 incentive (United 34). Investments related to business, as well as automobile use, would apply to the provision's requirements (United 34). The expensing deduction was raised to \$17,500 [$\$10,000 + (10,000 \times 0.75)$] through the Omnibus Budget Reconciliation Act of 1993 (Peters, "Clinton Remarks"). President Clinton remarked that politicians against the raise wanted to remove the deduction; businesses would have suffered greatly as a result (Peters, "Clinton Remarks"). The expensing deduction rose by another \$7,500 in the Small Business Job Protection Act of 1996 (Peters, "Clinton Statement"). President Clinton intended for the deduction to increase by \$15,000 through the Omnibus Budget Reconciliation Act of 1993 but Congress split the increase between the two Acts (Peters, "Clinton Statement"). Currently Section 179 allows businesses to expense investments that do not exceed \$200,000 (Fishman 210). The expensing deduction currently cannot exceed \$25,000 (Fishman 210).

There are similarities and differences between the investment tax credit and Section 179. Both are incentives that decrease the cost of capital expenditures. Purchases made by businesses cannot exceed a certain limit. Investments solely for business use qualified for both incentives. The ITC and Section 179 went through changes in federal legislation. However, a significant difference between them is the ITC is directly taken from taxes while Section 179 is deducted from the business income.

Conclusion

Table 7 summarizes the investment tax credit from its introduction to its termination through federal legislation:

Table 7						
Historic Summary of the ITC						
1962-Oct. 1966	Oct. 1966- Mar. 1967	Mar. 1967-1969	1969-1971	1971-1975	1975-1986	1986- Present
7%	0%	7%	0%	7%	10%	0%
Introduced	Suspended	Restored	Terminated	Reintroduced	Permanently raised	Eliminated

An important issue in the implementation of the investment tax credit involves the legislation's timing. Larson asserts that the restoration of the ITC in 1967 occurred too soon (65). Cummins states that low levels of investment result in an ITC introduction and high levels result in an ITC termination (132). Jorgenson believed the frequent changes to the ITC were unnecessary (209). The extant literature suggests that the ITC will not be as effective if the timing is off.

In conclusion, the investment tax credit can only be effective in the right situation. The state of the economy drives the introduction or termination of the ITC. The federal government suffers cost-wise while businesses benefit investment-wise with the ITC. Although the ITC may provide short-term benefits, long-term results can be inconsistent. Businesses and policy makers should evaluate the complexities of the ITC as they plan for the future.

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